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In the Supreme Court of the United States

OCTOBER TERM, 1943

No. 250

LELAND STANFORD JUNIOR UNIVERSITY and ELMER H. SHINE,
Petitioners,

vs.

THE NATIONAL SUPPLY COMPANY, a corporation,
Respondent.

BRIEF FOR RESPONDENT

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I.

OPINIONS BELOW

The opinion of the Circuit Court of Appeals for the Ninth Circuit is reported in 134 Fed.(2d) at pages 689-694 and appears also in the Record at pages 2986-3000. References herein to particular portions of such opinion are to the Record. The opinion of the District Court is not reported, but appears in the Record at pages 211-12.

II.

STATEMENT OF BASIS OF JURISDICTION

Petitioner invokes the jurisdiction of this Court under Section 240(a) of the Judicial Code, U.S.C.A., Title 28, Section 347(a).

Respondent invoked the jurisdiction of the District Court under Section 24(1) of the Judicial Code, U.S.C.A., Title 28, Section 41(1) pursuant to appropriate proceedings for removal from the state court because of diversity of citizenship under Section 28 of the Judicial Code, U.S.C.A., Title 28, Section 71.

Respondent invoked the jurisdiction of the Circuit Court of Appeals for the Ninth Circuit under Section 128(a) of the Judicial Code, U.S.C.A., Title 28, Section 225, subd. (a).

III.

ARGUMENT

Petitioner in effect asks for certiorari upon three grounds, to-wit: (1) The claim that the United States Circuit Court of Appeals did not give due consideration to claimed fraud of The National Supply Company of Delaware, one of the predecessors of respondent (hereinafter called the "Delaware corporation"), (2) the claim that the Delaware corporation violated the Federal Securities Act of 1933, and (3) the claim that petitioner was entitled to a hearing *in bank* by the United States Circuit Court of Appeals. The decision of the United States Circuit Court of Appeals was clearly right. In any event, no question

of public interest justifying review by this Court on certiorari is presented.

1. The Claim of Fraud.

The court dealt with both grounds advanced by the petitioner.

(1) The claim that the literature did not disclose that dissenting stockholders had a statutory right of appraisal is the only ground that was considered in the opinion of the District Court. The Circuit Court of Appeals disposed of this ground first by pointing out that the terms of the statute were incorporated as part of the corporate contract of which the stockholders must be deemed to have had knowledge. Then it went further and demonstrated in detail that the literature sent to the stockholders called attention to the statutory right not less than four times. Hence if the petitioner did not see these references, that was due to its own failure to read the literature rather than to any defect in the literature. The petitioner made the subsidiary claim that it was not advised that it could not keep its 7% preferred stock; but that claim, also, was disposed of as baseless by the Circuit Court of Appeals by detailed references to the literature.

(2) The claim that the plan was so unfair as to amount to a constructive fraud was outlined by the court but it found that it did not have to pass thereon because of its holding that the petitioner could no longer raise that question due to its laches. (However it is fairly inferable from the court's opinion that if it had believed it relevant to pass upon the fairness of the plan it would have found against the petitioner's contentions.) The opinion shows

clearly that the Circuit Court of Appeals paid full heed to the findings of the District Court but, after its own painstaking examination of the evidence, arrived at its own conclusions as to the facts, as it was authorized to do in a case in equity.

There was more than ample evidence of laches. There was no evidence to the contrary. Most of the circumstances showing laches are discussed in the opinion. It is unnecessary to quote therefrom. We confine ourselves to a listing of the elements (including those shown in the opinion) which establish beyond any doubt that laches existed.

(a) The notice of the stockholders' meeting of the Delaware corporation, together with the complete consolidation literature, was mailed to petitioner on August 10, 1937 (R. 664). The meeting was not to be held until October 11, 1937 (R. 72). The notice was given approximately sixty days in advance of the meeting, while the Delaware statute required only twenty days. Thus petitioner was given more than ample notice of what was to take place.

(b) On September 27, 1937, after an earlier meeting (at which no quorum was present), petitioner's investment committee (consisting of three prominent San Francisco business men (R. 443; 445; 461)) and petitioner's experienced paid analyst (R. 512-516) met and gave some consideration to the consolidation proposal (R. 490). The committee came to the conclusion that the Plan was grossly unfair; in fact, according to the testimony of one of the committee: "It looks crooked to me." (R. 450)

This conclusion was drawn approximately two weeks prior to the meeting. Thus petitioner was not lulled into any sense of security.

(c) Petitioner did not communicate with the Delaware corporation prior to the meeting, took no part in and was not even represented at the meeting (R. 686; 669), and did not communicate with respondent until some time thereafter (R. 686). Thus petitioner allowed the consolidation to become effective without any registered complaint.

(d) At the meeting, to-wit, on October 11, 1937, the stock of the Delaware corporation voted as follows: Of the 166,353 shares of 7% Preferred Stock outstanding, 116,564 shares, or approximately 70%, were voted in favor of the consolidation, and only 255 shares against it. The vote of the Common Stock was approximately 66.5% in favor of the consolidation, with only a few hundred shares opposing it (R. 114; 667). The vote of the Preferred stockholders was proportionately greater than that of the Common stockholders. Thus the other Preferred stockholders must have overwhelmingly favored the consolidation.

(e) The consolidation became effective on October 23, 1937, and all stockholders, including petitioner, were immediately notified (R. 497). On November 29, 1937, petitioner for the first time communicated with either the Delaware corporation or respondent (R. 686). On that date petitioner's analyst wrote the respondent, in effect, that petitioner was anxious to obtain more information before assenting to the Plan (R. 188). The analyst's letter

was disingenuous and could just as well have been written prior to the meeting, and no doubt, if written at that time, would have been followed by an appropriate answer. When it was at last written, the respondent corporation immediately replied that petitioner's right to dissent had ceased and that petitioner was bound by the consolidation (R. 687; 190). Thus for a period extending from approximately August 10 to November 29, 1937, three and one half months, petitioner still did nothing.

(f) In the meantime, in October of 1937, the new securities of the respondent corporation were listed upon the New York Stock Exchange, and thereafter freely dealt in. Transactions ran as high as several hundred shares daily (R. 952-994). Thus, the public became involved.

(g) Also in the fall of 1937 the New York Stock Market commenced to drop and continued to drop for some time thereafter (R. 1456). Thus, conditions were changing.

(h) In the meantime petitioner received and cashed and retained until the end of April, 1938, without tendering back, the proceeds of four checks for the payment of dividends upon respondent's new securities (R. 1716). A dividend check for the 5½% Preferred Stock was received in December of 1937 (R. 576). An additional check for the dividend on this stock was received in April of 1938 (R. 575). Each of these dividend checks was accompanied by a check for the dividend on the $2.00 Preference Stock (R. 577; 594). Counsel attempt to argue that these dividend checks were received by petitioner in the belief that they represented dividends upon the old 7% Preferred Stock of the Delaware corporation, and that just as soon as petitioner discovered the contrary it tendered back

the amounts represented thereby. The fallacy is apparent. A dividend upon the old 7% Preferred Stock would have been in one check, not in two checks. In addition thereto, on the old securities respondent's dividend would have been 7% or $2275. On the new securities the combined dividend amounted to 7½% or $2437.50. Thus, petitioner was either paying no attention whatsoever to its holdings or was speculating.

(i) Petitioner did not commence suit until May 11, 1938 (R. 146). This was nine months after its first notice of the consolidation.

The Circuit Court of Appeals took very great pains to examine the literature sent to the stockholders of the Delaware corporation. There were, probably, two reasons: The first reason was that the opinion of the District Court (R. 211) was based solely upon the conclusion that the Delaware corporation did not inform petitioner of its rights to object to the consolidation at or prior to the stockholders' meeting and to obtain the value of its holdings in cash.* The second reason no doubt was that the Circuit Court of Appeals desired to show that there was nothing in this literature which would in any way detract from its conclusion that laches existed. The Circuit Court of Appeals demonstrated (R. 2995-2998) that the literature would have shown to any reasonable person reading the same that the right to object and obtain the value of the shares existed. The Circuit Court of Appeals furthermore demonstrated that the literature was clear as to any further element

*It is true that elaborate findings were prepared. These findings were the work of petitioner's counsel.

that could possibly have been material to petitioner. Petitioner did not read the literature.

In the light of the foregoing we briefly dispose of counsel's arguments.

(a) Counsel claim that even though petitioner may have been guilty of negligence, the Delaware corporation was guilty of an intentional wrong and that negligence is no defense to a suit based upon an intentional wrong. They argue from the law of personal injuries. Their argument is entirely foreign. We are dealing with none other than laches. Counsel have cited no cases that the doctrine of laches cannot be applied to actions based upon intentional wrongs. Counsel forget that the rights of other stockholders were at the time of the stockholders' meeting and ever since that time have been involved. These were not only stockholders who held stock in the Delaware corporation at the time of the consolidation, but also those who bought stock in respondent since the consolidation. Petitioner certainly cannot impugn the honesty of these stockholders.

As pointed out in the opinion of the court (R. 2992), the stockholders of the Delaware corporation were entitled to rely on the status of things as they appeared at the meeting and in their voting to govern themselves accordingly. They had a right to be advised of the number of shares objecting to the consolidation, since these objections foreshadowed money demands to be made upon the new company. Furthermore, the court emphasized (R. 2993) a matter of greater importance, and that was that the public, in acquiring securities of this

respondent, were entitled to know the exact situation and should not be prejudiced by objections belatedly asserted.

In other words, the rights of third parties intervened and, no longer, was it a case, if it ever had been, between merely the petitioner and the officers and directors of the Delaware corporation. When the rights of third parties intervene, or conditions change, the doctrine of laches should be freely applied.

Hayward v. National Bank, 96 U.S. 611;
Brown v. County of Buena Vista, 95 U.S. 157;
Penn Mutual Life Insurance Co. v. Austin, 168 U.S. 685.

(b) Counsel claim that even though petitioner may have been negligent in failing to read the literature, that particular negligence could only have contributed to the loss of the right of appraisal under the Delaware statute, and could not have contributed to the claimed unfairness and claimed fraudulent nature of the consolidation plan. What we have said under (a) above is an answer. The question is one of laches. We need go no further, except to comment that counsel claim the court must have held that the right of appraisal under Delaware law was the only right that petitioner had. It was not only unnecessary for the court to so hold, but the court expressly states to the contrary. It states (R. 2993): "It may be conceded that these considerations do not in all circumstances require that a dissatisfied stockholder be denied relief if he has failed seasonably to dissent."

(c) Counsel claim that the Circuit Court of Appeals erred in not passing upon the fairness or unfairness of

the plan. As heretofore stated, inasmuch as the court found that the petitioner was barred by its laches from raising the claim of unfairness, it necessarily had no occasion to go into the claim. But one cannot read the opinion of the court without feeling that the court was out of sympathy with the petitioner's contention and that it would have rejected petitioner's claim had a decision on the point been necessary.

(d) Counsel argue that the Circuit Court of Appeals violated Rule 52(a) of the Federal Rules of Civil Procedure, since it was met by the findings and entirely ignored them. The answer is that the elements upon which the court relied are absolutely uncontradicted in the record. There are no elements having to do with the defense of laches which are to the contrary. The decision is based upon the literature, uncontradicted testimony, admissions and stipulations.

The reason for the existence of this litigation finds echo in the court's opinion, where the court states that a stockholder "may not by inaction speculate upon the outcome of the merger." (R. 2993) There was plenty of support for this view, as shown by the opinion. In addition, the minutes of petitioner's own investment committee contained the following rather startling language:

> "It was understood that they (McCutchen, Olney, Mannon and Greene) contemplated entering a suit to establish the University's position and then wait until such time as the recoverable value could be more nearly ascertained before proceeding further." (Underscoring ours.) (R. 508-509)

The language of Mr. Justice Harlan, in the case of *Hayward v. National Bank,* 96 U.S. 611, at 618, and the quotation therein contained, is very much in point:

> "The question of acquiescence or delay may often be controlled by the nature of the property which is the subject of litigation. 'A delay which might have been of no consequence in an ordinary case, may be amply sufficient to bar relief when the property is of a speculative character, or is subject to contingencies, or where the rights and liabilities of others have been in the mean time varied. If the property is of a speculative or precarious nature, it is the duty of a man complaining of fraud to put forward his complaint at the earliest possible time. He cannot be allowed to remain passive, prepared to affirm the transaction if the concern should prosper, or to repudiate it if that should prove to his advantage.' Kerr, Mistake and Fraud (Bump's ed.), pp. 302, 306." (Underscoring ours.)

It will be recalled that respondent's new securities had been listed on the New York Stock Exchange in October of 1937. Constant fluctuations followed (R. 952-994). The truth of the matter is that the petitioner was speculating.

2. The Federal Securities Act of 1933.

Respondent's position in this case has always been and is entirely consistent with the position taken by the Securities and Exchange Commission. The Securities and Exchange Commission promulgated its Rule 5(2) to its Form E-1. The note to this Rule is of importance

so we set it out *in toto* in the Appendix to this brief. It accords with respondent's position.

The Commission, also, caused to be filed, not only in the District Court but in the Circuit Court of Appeals, a brief as *amicus curiae* in support of its and our position. The Commission first argued that there was no sale, within the meaning of the Act, involved. A part of its argument in support of its and our position, as set forth in its brief before the Circuit Court of Appeals, was as follows:

> "In such consolidations and mergers the alteration of the stockholder's security occurs not because he consents to an exchange, but because *the corporation by authorized corporate action converts his security* from one form to another. That is to say (as indicated by the Note to Rule 5), there is no sale where (1) the vote of the stockholders is effective (subject to directors' action and other statutory requirements) as *corporate action* and (2) this action *binds all stockholders,* assenters, dissenters, and non-voters alike (subject only to appraisal rights of dissenters). The essence of the Commission's construction, as expressed in the Note, is that in such cases a proposed corporate act is submitted to stockholders to be accepted or rejected by them *as a class, in their capacity as members of the corporate body.* Even though the stockholder may participate in the vote which results in changing his rights as a stockholder, his action in so doing is the action of a member of the corporation exercising his franchise, rather than the action of a security-holder choosing to accept an offer of exchange made to him as an individual; and

obversely, the solicitation of his vote is nothing more than a request for the exercise of his franchise as a member of the corporation, not an offer of exchange or sale of new securities to him as an individual. He is functioning precisely as he would be if he were voting on a charter amendment which would, for example, change the corporate purposes. The fact that his rights will be changed if the consolidation or merger is effected is a mere incident of the corporate action in which he is participating."

In addition to the foregoing, and as a separate argument, the Commission stressed Section 19(a) of the Act. We quote it as follows:

"No provision of this title imposing any liability shall apply to any act done or omitted in good faith in conformity with any rule or regulation of the Commission, notwithstanding that such rule or regulation may, after such act or omission, be amended or rescinded or be determined by judicial or other authority to be invalid for any reason."

We had in similar manner stressed Section 19(a). We need go no further than to quote from the Commission's brief as follows:

"The appellees assume that the Note constitutes a 'rule or regulation of the Commission' under Section 19(a), but contend that the Commission 'is without authority to create *exemptions* by rule or regulations' (Brief for Appellees, page 69). The pertinency of this contention is difficult to understand in view of the express language in Section 19(a): 'notwithstanding that such rule or regulation may, after such act or

omission, * * * be determined by judicial or other authority to be invalid for any reason.' The validity of this rule of the Commission is, therefore, immaterial to the applicability of Section 19(a) to protect the appellant. See Lee, *Legislative and Interpretive Regulations* (1940) 20 Geo. L. J. 1, 30-31."

We also argued that, for a case to arise under the Securities Act, it must be for the enforcement of a remedy given by that Act, and that petitioner was seeking no such remedy. We consider, however, that it would be superfluous to present this point.

3. The Petition for Rehearing in Bank.

Counsel point to no law or authority or to any rule or intimation by any court that counsel was entitled to have their petition passed upon by all of the Judges of the Circuit Court of Appeals for the Ninth Circuit. A rehearing *in bank* is not a matter of right. It is a matter of grace. If every petition for a rehearing *in bank* is required to be passed upon by the entire court, each such petition would in effect bring about such hearing, since all of the Judges would be required to pass thereon. If such rule were adopted, the very purpose of having more than three Circuit Judges in a Circuit would be largely thwarted. The purpose of additional Judges is to expedite the decision of cases; the rule for which counsel argue would decidedly slow down the procedure.

It is unnecessary to point out that counsel's argument has nothing whatsoever to do with the merits of the litigation.

Respondent urges that the writ be denied.

Respectfully submitted,

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(APPENDIX FOLLOWS)